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REGULATORY AUTH.  
**BEFORE THE TENNESSEE REGULATORY AUTHORITY**

**NASHVILLE, TENNESSEE**

**April 9, 2002**

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OFFICE OF THE  
EXECUTIVE SECRETARY

**IN RE:**

**CONDO VILLAS OF GATLINBURG  
ASSOCIATION, INC.  
COMPLIANCE AUDIT**

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)  
) **Docket No. 01-00797**  
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**NOTICE OF FILING BY ENERGY AND WATER DIVISION OF THE TENNESSEE  
REGULATORY AUTHORITY**

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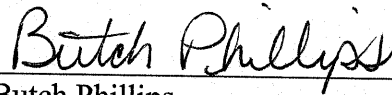
Pursuant to Tenn. Code Ann. §§ 65-4-104, 65-4-111 and 65-3-108, Energy and Water Division of the Tennessee Regulatory Authority gives notice of its filing of the Condo Villas of Gatlinburg Association, Inc.'s Compliance Audit Report in this docket and would respectfully state as follows:

1. The present docket was opened by the Authority to hear matters arising out of the audit of Condo Villas of Gatlinburg Association, Inc. (the "Company").
2. The Staff began its audit on September 25, 2001 and the completed its audit of same on February 12, 2002.
3. On February 12, 2002, the Energy and Water Division issued its preliminary compliance audit findings to the Company, and on April 1, 2002, the Company responded thereto.

4. The preliminary compliance audit report was modified to reflect the Company's responses and a final compliance audit report (the "Report") resulted therefrom. The Report is attached hereto as Exhibit A and is fully incorporated herein by this reference. The Report contains the audit findings of the Energy and Water Division, the Company's responses thereto and the recommendations of the Energy and Water Division in connection therewith.

5. The Energy and Water Division hereby files its Report with the Tennessee Regulatory Authority for deposit as a public record and approval of the recommendations and findings contained therein.

Respectfully Submitted:

A handwritten signature in cursive script that reads "Butch Phillips". The signature is written in dark ink and is positioned above a horizontal line.

Butch Phillips  
Energy and Water Division of the  
Tennessee Regulatory Authority

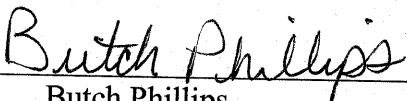
**CERTIFICATE OF SERVICE**

I hereby certify that on this 9th day of April, 2002, a true and exact copy of the foregoing has been either hand-delivered or delivered via U.S. Mail, postage pre-paid, to the following persons:

Mr. K. David Waddell  
Executive Secretary  
Tennessee Regulatory Authority  
460 James Robertson Parkway  
Nashville, TN 37243

Mr. Earl Baird, Manager  
Foothills Water Properties, Inc.  
814 Foothills Drive  
Gatlinburg, Tennessee 37738

Mr. Wayne Campbell, CPA  
P. O. Box 1386  
Knoxville, Tennessee 37901

  
\_\_\_\_\_  
Butch Phillips

**COMPLIANCE AUDIT REPORT**  
**OF**  
**CONDO VILLAS OF GATLINBURG ASSOCIATION, INC.**

**DOCKET NO. 01-00797**

**PREPARED BY**  
**TENNESSEE REGULATORY AUTHORITY**  
**ENERGY AND WATER DIVISION**

**April 2002**

**EXHIBIT A**

COMPLIANCE AUDIT

**CONDO VILLAS OF GATLINBURG, INC.**

DOCKET NO. 01-00797

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## **I. INTRODUCTION**

The subject of this audit is Condo Villas of Gatlinburg Association, Inc. ("Company" or "Foothills") compliance with the Rules and Regulations of the Tennessee Regulatory Authority ("TRA" or the "Authority"). At the direction of the Energy and Water Division's Chief, Dan McCormac, the compliance audit was requested and performed by Butch Phillips of the Energy and Water Division.

## **II. BACKGROUND**

Foothills is a small water system located in Gatlinburg, Tennessee in Sevier County. It is owned solely by Foothills Water Properties, Inc. The company currently has approximately 91 water customers.

The company was originally owned and operated by Mr. Tony Rast. Mr. Rast petitioned for a Certificate of Public Convenience and Necessity ("CCN") from the Tennessee Public Service Commission ("TPSC") in 1990 (Docket No. 90-02584). Approval was given on February 28, 1992. Mr. Rast sold the utility system during 2000 to Foothills and approval was given by this Authority to transfer it's CCN. The service territory of the utility consists of residential property developed by Mr. Rast. During 2001 the Company changed its corporate name to Foothills Water Properties, Inc.

The Authority Staff conducted an on-site audit of the Company's books and records at the Company's accountant's office (Wayne Campbell, CPA) located at 222 East Broadway Street, Suite # 201, Jefferson City, Tennessee. The Staff's findings and recommendations resulting from the audit can be found in section VI of this report.

### **III. JURISDICTION OF THE TENNESSEE REGULATORY AUTHORITY**

Tennessee Code Annotated (T.C.A.) gives jurisdiction and control over public utilities to the Tennessee Regulatory Authority. T.C.A. §65-4-104 states that:

The [A]uthority has general supervisory and regulatory power, jurisdiction, and control over all public utilities, and also over their property, property rights, facilities, and franchises, so far as may be necessary for the purpose of carrying out the provisions of this chapter.

Further, T.C.A. §65-4-105 grants the same power to the Authority with reference to all public utilities within its jurisdiction as chapters 3 and 5 of Title 65 of the T.C.A. have conferred on the Department of Transportation's oversight of the railroads or the Department of Safety's oversight of transportation companies. By virtue of T.C.A. §65-3-108, this power includes the right to audit:

The department is given full power to examine the books and papers of the companies, and to examine, under oath, the officers, agents, and employees of the companies and any other persons, to procure the necessary information to intelligently and justly discharge its duties and carry out the provisions of this chapter and chapter 5 of this title.

The Energy and Water Division of the TRA is responsible for auditing those companies under the Division's jurisdiction to ensure that each company is abiding by the above-stated statute as well as the Rules and Regulations of the Authority.

### **IV. SCOPE OF AUDIT**

The Staff examined Aqua's books and records for the twelve months ended December 31, 2000, and conducted tests of accounts as it considered necessary to determine if the Company is following the Uniform System of Accounts for Class C Water utilities along with TRA rules, regulations, and other directives.

## **V. STAFF SUMMARY**

The Company has not come under review by this Agency since 2000 (Docket No. 00-00446). The Company has never sought to have its rates amended since the Company was formed.

The Company does not have its financial records in compliance with USOA and needs to have its financial records in compliance with TRA directives as soon as possible. The Staff has outlined the material deficiencies in this report and will work with the utility to ensure compliance. Foothills has access to outside accounting personnel to assist in maintaining financial compliance.

The Company received approval to collect a tap fee in TPSC Order No. 90-02584 in the amount of \$750. The Staff through its investigation discovered that not all of the tap fees were recorded on its books and some were recorded improperly as revenue.

Foothills during 1999 entered into an agreement with the former owner, Mr. Rast, to transfer ownership of the assets of the company. The signed agreement between the parties contained a provision allowing Mr. Rast to receive up to twenty-five free taps. The Company did not record a deferred credit on its books to reflect the contingent liability that resulted from the transfer of ownership.



## **VI. AUDIT FINDINGS**

### **FINDING # 1:**

#### **Exception**

The Company does not keep its books in accordance with the Uniform System of Accounts.

#### **Discussion**

TRA Rule 1220-4-1-.11(1)(g) for Class A, B, and C water companies requires utilities to follow the Uniform System of Accounts (USOA) as adopted and amended by the National Association of Regulatory Utility Commissioners (NARUC). This uniform record keeping insures the integrity, reliability and comparability among similar companies of financial data contained in financial reports submitted to the Authority. It provides the TRA one of its most useful regulatory tools for establishing just and reasonable rates. We noted the following exceptions to the USOA:

- a. The Company's chart of accounts does not comply with the USOA.
- b. Many entries in the Company's books are not kept "in such a manner to support fully the facts pertaining to such entries."<sup>1</sup>

This finding has no immediate effect on rates that the company is authorized to charge.

#### **Recommendation**

We recommend that the Company make the necessary changes in its accounting methods and procedures to comply with the Uniform System of Accounts for Class C Water Utilities, beginning with calendar year 2002. The Company should also provide Staff with evidence of compliance no later than thirty (30) days after the Director's approval of this finding.

#### **Company Response**

The Company has complied with this finding effective January 1, 2001. Foothills Water Properties, Inc. was acquired by gift from Mr. Tony Rast effective January 1, 2000. In the summer of 2000 Wayne Campbell, CPA for the company attended a workshop in Nashville at the offices of The Tennessee Regulatory Authority. This excellent seminar

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<sup>1</sup> National Association of Regulatory Utility Commissioners "1996 Uniform System of Accounts for Class C Water Utilities", Accounting Instructions, page 8, section 2., paragraph B.

was conducted by Mr. Butch Phillips and information received at this workshop provided our staff with materials for compliance with TRA requirements.

## **FINDING # 2:**

### **Exception**

The Company failed to properly record tap fees as prescribed in TPSC Order No. 90-02584.

### **Discussion:**

The Company was granted approval of a \$750.00 tap fee in TPSC Order No. 90-02584. Any tap fees collected were to be used for plant expansion. The Company did collect \$1,500 from customers as tap fees during 2000. The funds were recorded as revenue. The company did not have approval from this Authority to record them in this manner. This had the effect of overstating their revenue for the period audited.

Another problem exists as well. In TPSC Order No. 90-02584 it was stated that Foothills had 77 customers at the time the petition was filed. The system now has 91 customers with a difference of 14 additions since the approval of the CCN. However, no Contributions In Aid of Construction ("CIAC") have been recorded in its ledgers. The Company should have charged and collected a tap fee in the amount of \$750 from each one of these additional customers (less the two that were collected and recorded as revenue during 2000) and recorded the collected funds as CIAC. The additional amount not recorded was \$9,000 (12 customers x \$750). The net effect of making the correcting accounting entries would be a \$10,500 (\$9,000 + \$1,500) reduction in their rate base.

The Company also did not record any corresponding CIAC amortization. The Staff cannot accurately determine when each tap was installed by the utility and as such used 2000 the starting point to begin amortization of the CIAC. To be consistent with TRA policies the Staff used an average rate of four percent annually. The Staff recalculated the balance at December 31, 2000 to be \$420 (\$10,500 x 4%). The Staff would recommend that the Company use the above rate unless it can prove why another rate should be used in calculating the amortization.

### **Recommendation:**

The Company should be directed to make the correcting accounting entries to reflect the CIAC and associated amortization no later than thirty (30) days after approval of this recommendation. Also, properly record any future tap fee collections as CIAC and amortize consistently with TRA practices.

**Company Response:**

The company has made the correcting accounting entries to reflect proper entries for tap fees.

### **FINDING # 3:**

#### **Exception:**

The Company entered into an agreement during 1999 with the prior owner to waive up to potentially twenty-five taps fees without prior approval of this Authority. The Company also failed to record the liability associated with the previously agreed forgiven tap fees.

#### **Discussion:**

In Docket No. 00-00046 the Authority approved the transfer of ownership between the current owners and the prior owner, Mr. Tony Rast. Contained in the petition was a copy of the written purchase agreement between the above parties. The agreement contained a provision for Mr. Rast to receive up to twenty-five taps free of charge from the utility for any parcels of land that he may develop in the future. The total potential value of forgiven tap fees is \$18,750 (\$750 x 25). The provision expires on December 31, 2005.

The Authority did not address the treatment of this provision in its Order issued on October 10, 2000. T. C. A. § 65-5-204 prohibits any public utility from imposing any rate that is unjustly discriminatory. Waiving tap fees for Mr. Rast could be considered unjust and unfair to the other potential customers who would otherwise be required to pay the initial tap fee. It is also unfair treatment to the current customers if this loss in cash flow will have to be made up from them at some point in the future. Generally tap fees are approved by a regulatory body to assist the utility to recover the huge amounts of initial (or future in some cases) plant costs. If the utility does not recover these identified costs then it will have to seek recovery in the future from its existing customer base to provide a return on the investment caused by the forgiven tap fees.

Given the potential financial hardship that this may cause for the customers of Foothills, the Staff would prefer to treat any forgiven taps to Mr. Rast as CIAC and require that the Company's shareholders bear the loss of any tap fee recovery from Mr. Rast.<sup>2</sup>

The Uniform System of Accounts for Class C Water Utilities, Account No. 253, Other Deferred Credits, states "This account shall include, gains on disposition of property, net of income taxes, deferred by authorization of the Commission, advance billings and receipts and other deferred credit items, not provided elsewhere, including amounts which cannot be entirely cleared or disposed of until additional information has been received."

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<sup>2</sup> In Docket No. 99-00507, Petition of Lynwood Utility Corporation to Change and Increase Rates and Charges, the Authority Directors required restitution be made for uncollected tap fees by Lynwoods's prior owner.

Clearly a liability exists, but even though the total amount of forgiven tap fees is known neither the Company nor the Staff knows when and if the total will be exercised before the expiration of the options is due. The proper accounting treatment in this case should be a credit to the above USOA account and a debit to the Company's Retained Earnings account to recognize the liability and prior period adjustment. Also, the Company should be directed to reduce the liability by the amount of taps fees in the period they are actually awarded to Mr. Rast and record these amounts as CIAC. If any of the twenty-five taps are not exercised by the expiration of the option then the remaining liability should be removed from the Company's books and its Retained Earnings be increased at that time.<sup>3</sup>

**Recommendation:**

The Company should be made to record this liability to conform to USOA and should submit proof to this Authority no later than thirty (30) days after the Director's approval of this finding.

**Company Response:**

The company has accepted the audit recommendation and complied with same.

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<sup>3</sup> The impact of any unused portion of the deferred credit should be addressed during any future rate increase petition filed by Foothills.